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First National City Bank Monthly Letter

Business and Economic Conditions

New York, March, 1956

General Business Conditions

THE news that President Eisenhower will run for a second term has removed one of the major uncertainties surrounding the business outlook in recent months. This announcement will bolster optimism in view of the confidence with which the business and investment community has regarded the present Administration. There is no way of knowing precisely how much political uncertainties weigh in business decisions, and there has been much reason to believe that the forward plans of business men, involving record expenditures for plant and equipment, were firmly grounded on faith in expanding markets and need to keep up with competition in introducing new products, cutting costs, and building for the future. Nevertheless, the political climate is always to be reckoned with.

The new year appears to be carrying on where the old year left off, with little change in the high rate of business activity. The long rise in over-all production and trade evidently has come to a halting point, but there are few indications of decline. Industrial production, retail sales, and construction work in January, on a seasonally adjusted basis, were about the same as in December, and the highest for any January in history. Preliminary data indicate that business in February has followed much the same level course. Compared with the first two months of 1955 substantial gains, in the neighborhood of 5 to 9 per cent for various measures of production and trade, have been realized. The forecasters who have so generally predicted that 1956 in the aggregate will show increases over 1955 can show that so far the figures are running their way, and that gains are being accumulated against the time when comparisons may be less favorable.

The industrial production index, seasonally adjusted, has held at 143 or 144 (1947-49 = 100) since last October. This is a record high level. Retail sales, after seasonal correction, have moved sideways for the same length of time. The stability of these and other comprehensive measures, however, does not signify a standstill in business. It conceals adjustments of output in individual lines, shifts in markets, and changes in inventory and order positions. The principal curtailment has been in passenger car output; automobile sales, seasonally adjusted, have also declined somewhat. But during the same period the soft goods industries and mining have advanced to new highs, and despite the automobile slackening durable goods production has been maintained close to its peak by increased output of machinery and equipment, trucks, building materials, and steel. Retail sales of other goods have expanded to offset the easing in automobile sales. Thus adjustments are being made without marked effect on aggregate activity.

Auto and Housing Drops Flattening Out?

It is possible that the reduction of passenger automobile output has now gone about as far

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as necessary. Since mid-November, when output of 1956 models reached its peak, the cutback has been more than 30 per cent. Original assembly schedules were over-optimistic and inventories mounted rapidly. By the end of January dealers were holding record-breaking stocks of 830,000 new cars, according to Ward's Automotive Reports, and a further increase occurred in February. However, latest figures on output – 124,500 in the week ended February 25 – are roughly in line with estimated current sales and exports. From this point on the spring upturn in new car sales should be under way, and if it is as marked as usual it will cut away excess dealers' stocks during the spring months without further curtailment. The decline in sales has been more moderate than the production cutback. In fact, only since mid-January have sales of the 1956 models fallen behind the phenomenal pace of the 1955s.

There are also signs that the decline in homebuilding is making a bottom, for despite severe weather the seasonally adjusted annual rate of new homes started in January remained close to the November-December rate of 1.2 million. Contract awards for residential construction during the first seven weeks of 1956, as compiled by F. W. Dodge Corporation, were higher than a year ago, and Federal Housing Administration officials report that "mortgage money was more readily available in early 1956 than in other recent months". The discounts at which outstanding insured and guaranteed mortgages have been selling have narrowed a little, and appraisals requested from the Veterans Administration have turned upward again. In conjunction with earlier steps to ease the mortgage tightness, these are fairly convincing indications that the decline in housing construction is flattening out. As an influence on general business, its weakness is behind rather than ahead.

The Strong Points

If in fact production in these two industries is bottoming out, little reason will be left for expecting any marked spring decline in industrial operations. Persistent shortages in some of the nonferrous metals, paper, most types of steel, and other materials keep production in those lines virtually at the limits of capacity. The textile and other soft goods industries are giving strong support to business with order books well filled. Adjustments in these various lines may become necessary in 1956, owing to inventory accumulation or untenable price advances, but evidently they are not imminent.

The machinery and equipment industries are sold far ahead and are striving to increase output. The automobile industry alone is planning to spend approximately $2 billion in 1956 on expansion and modernization of its facilities, not including the extensive and costly retooling for '57 models. To some extent, by increasing its capital outlays more than two-thirds over 1955, the auto industry is offsetting the effects of its own production cutbacks. Plans have been drawn, contracts let, and orders placed for heavy capital expenditures, and it would take a pronounced jolt to the economy to cause a significant reduction in business spending before the end of the year.

Business Sentiment and Consumer Spending

Since the business rise seemingly has leveled off, at least in terms of physical volume, psychological reactions to this fact may significantly influence business trends. Among industrial purchasing agents a slight tendency to shorten commitments is reported, but it is not carried far by reason of the upward trend of industrial prices and the prospect that this trend will continue as wage rates and costs rise during 1956. Conservatism among purchasing agents is not to be deplored, but the contrary. It will tend to keep down inventory accumulation, brake price advances and keep the markets healthy.

How consumers may react to the leveling out of business and what they decide to do with their money will also be significant. In recent years business forecasters have found consumer expenditures the most difficult of all business factors to project. From 1945 and 1946 on, forecasts have gone wrong more often because of inability to size up consumer expenditures correctly than for any other reason. Few thought the 1955 expansion would be so vigorous and rapid, and the chief reason for the underestimation was failure to anticipate that consumers would be so receptive to new automobile models and new housing, and so willing to go into debt or to reduce savings in order to buy these and other goods.

Thus far in 1956 consumer expenditures show no sign of faltering. Department stores reported January sales, seasonally adjusted, equal to the all-time peak set five years earlier during the Korean War scare-buying. February sales have continued at a lively pace, averaging about 5 per cent higher than a year earlier during the first three weeks of the month. Evidently people in 1956 will spend less on automobiles. They may replenish savings, repay debt, or spend more for other things. In general, people ap-

pear to be spending as many dollars as before, shifting from one type of purchase to another. At the same time they are able to increase savings and debt retirement because disposable incomes have increased.

Personal income reached the all-time peak rate of $315 billion per year in December. The increase of $3 billion over November was attributable to a considerable extent to year-end dividend disbursements. In the opening months of 1956 this increase will be hard to match. Unless the effect of higher wage rates on money income is nullified by business recession and lessened employment, however, personal income will increase further.

By law, the minimum wage for workers in interstate commerce is increasing from $.75 to $1.00 per hour on March 1; the U.S. Department of Labor estimates that 2.1 million workers will get raises aggregating $560 million a year. The Labor Department has also estimated that during 1956, under existing union-management contracts, at least 2,750,000 workers will receive automatic wage increases, such as the automobile workers' annual 6 cent per hour "productivity adjustment". Both these moves will create demands for adjustment of salary scales of other workers in the same plant, industry, or locality.

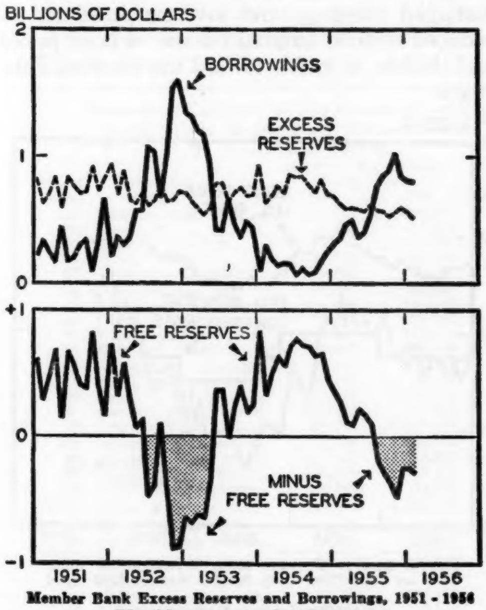
Union Demands

Such gains, together with the excellent 1955 profits reported by most corporations, will give union leaders a tempting target to shoot at in this year's extensive negotiations, and it is clear that union demands will be heavy. If wage increases exceed gains in productivity they will put further upward pressure upon costs and hence upon prices. People who think the slackening in automobile output and housing construction has relieved inflationary dangers should take account of these cost-price pressures. The seeming stability of price indexes in this country is deceptive, since it conceals an almost steady rise in prices of industrial products since late 1954, and an almost equally steady decline in farm products. Since the middle of January farm prices have been firmer. With their offsetting influence removed, the wholesale price index has advanced during that period to the highest level since August 1952. This recent action is in contrast to most other business indicators.

The danger of excessive wage increases is in fact a double one. They may force up costs and prices to a point where farmers and other people who do not have equivalent increases in income cannot buy. In that event sales will drop and the assumed gains of higher wage rates will be lost through unemployment. The alternative is that higher prices may be validated by inflation of demand through excessive credit expansion. This is a choice of evils which the country should not have to make.

Credit Developments

January and February brought an easier feel to the markets for borrowed money. Although the Federal Reserve Banks sold Treasury bills on the usual heavy scale to absorb funds gained by the banks from seasonal return flow of currency, they did not attempt to redevelop the full pressure the banks had experienced in November. As the chart shows, banks found it necessary to borrow from the Federal Reserve a daily average of around $800 million in January and February compared to the recent peak of $1 billion in November.



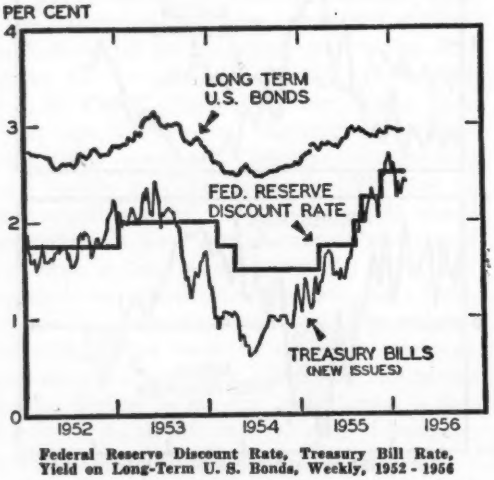
Member Bank Excess Reserves and Borrowings, 1951 - 1956
(Monthly averages of daily figures)

More significant, the Federal Reserve authorities let January pass without a further discount rate advance. Rather widespread anticipations of such action had held the market under restraint around the year-end and had helped to put the average yield on new issues of Treasury bills up to a new peak of 2.69 per cent. By the close of January the conviction was widely shared that the risk of another discount rate boost had passed. Toward the end of February the Federal Reserve became a buyer of Treasury bills, easing bank reserve positions and preparing the ground for a refunding in March of

$9½ billion maturing Treasury notes. The yield on new Treasury bill issues declined from an average of 2.56 per cent in December to 2.46 in January and 2.37 per cent in February.

Bankers acceptances were marked down ⅛ per cent on January 19, reducing the yield offered on a prime 90-day acceptance to 2⅜ per cent. Commercial and finance paper rates held at their December peak levels throughout January and February, a reflection of strong business demands for credit.

Bond prices rose strongly in January and the first half of February, inviting increased offerings which were not slow to appear. The New York Thruway sold $50 million serial bonds on February 15 at a 2.42 per cent average interest cost. On a similar offering in December the Thruway had paid 2.74 per cent. Top grade corporate bonds were placed at rates around 3⅛ per cent compared to 3 5/16 in December. Enlarged offerings, and investor resistance to reduced returns, arrested the rise of bond prices and decline in yields toward the close of February.



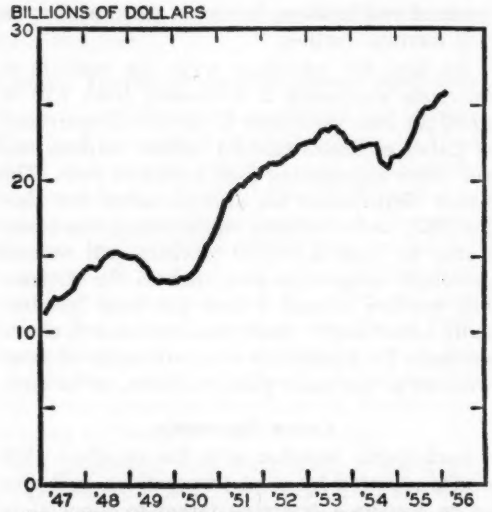
Federal Reserve Discount Rate, Treasury Bill Rate, Yield on Long-Term U. S. Bonds, Weekly, 1952 - 1956

Business Loans

The congestion of the mortgage market, which developed last summer out of the efforts to curb excessive building, has cleared up. Discounts on FHA and VA mortgages have narrowed and conventional loans are generally in better supply.

Many life insurance companies, savings banks and savings and loan associations have increased their mortgage loan programs. Commercial banks, faced with unseasonably heavy demands from business borrowers, are participating less actively in mortgage lending and also have reduced loans on securities.

Business loans of the weekly reporting member banks for the first seven weeks of 1956 declined $402 million which is less than usual for this time of year. The decline was entirely accounted for by sales finance company repayments related to the drop in Treasury bill yields and the improving bond market. The drop in Treasury bill yields enlarged the market for sales finance company paper sold in the open market, and some of the major companies took advantage of the improved demand for bonds to float new issues, partly for purposes of refunding bank loans.



Seasonally Adjusted Business Loans of Weekly Reporting Member Banks, Monthly 1947-56
(Plottings are for final Wednesdays except February 1956 which is plotted at February 15, latest available date.)

The chart above shows the movements of weekly reporting member banks' business loans, seasonally adjusted, since 1947. The current rise, which began in November, 1954, was somewhat retarded after the discount rate advances of last summer and fall. Nevertheless, it has carried the total from $21 billion up to $25.7 billion, or 22 per cent in fifteen months' time.

This is the third main advance in business loans since World War II. The first ran for three years, 1945-48. The second, intensified by the Korean War, went on for three and a half years, from the winter of 1949-50 to the summer of 1953.

There are no present signs that an easier Federal Reserve credit policy is needed to support business. Banks are necessarily more discriminating in granting credits. While loans have held up, deposits have declined in the full seasonal proportions, particularly in the major financial centers. To accommodate borrowing customers banks have been selling investments at an average rate of $200 million a week. Sale of

investments on such a scale is indicative of a strong pressure of loan demands, for the sales involve losses which banks are naturally reluctant to take.

Considering the heavy volume of business being carried on, the record-high levels of production costs, and the tremendous capital programs under way by industrial enterprises, public utility firms, and governmental bodies, credit demands could hardly be anything but correspondingly strong. The tendency, not only among business and public enterprises but also among consumers, is to use credit so as to spend tomorrow's income today.

Hazards of Inflation

This tendency, which so easily spills over into inflation, is by no means limited to the United States. Other nations have had to go much further in tightening their money markets to hold or regain stability. The Bank of England's discount rate on February 16 was raised from 4½ to 5½ per cent, highest in twenty-four years, as part of an intensified program to protect the pound sterling.

Inflation in the United Kingdom has created a balance of payments problem: difficulties of holding down imports, raising exports, and commanding the confidence of foreigners in sterling. But, quite apart from these vital aspects, continuing inflation is being recognized as a social evil of the first magnitude. In the 1955 annual report for Lloyds Bank, Sir Oliver Franks, the chairman, reminds us:

> [Inflation] produces an arbitrary and haphazard redistribution of purchasing power, favouring those whose bargaining power is strong while expropriating those whose incomes are fixed in terms of money, whose bargaining power is weak or who observe restraint in the exercise of the bargaining power they possess. It is the great enemy of thrift. It makes for easier profits from borrowed money; it must defraud the saver who is the ultimate provider of the borrowed funds. It undermines the whole fabric of long-term contracts on which civilized economic life depends.
>
> "The importance of money essentially flows," as Keynes reminded us, "from its being a link between the present and the future." For the present generation of savers the link has been an unreliable one. In recent years we have seen trustees and other responsible investors who would normally hold fixed-interest securities moving into equity investment on a large scale in the hope that this would afford some protection against the erosion of real value to which government securities and all other claims to money have been subject. This illustrates how much can be lost if the future value of money is seriously questioned.

Corporate Earnings in 1955

Annual reports of over two thousand companies published to date for the year 1955 show in most cases increases over 1954 in sales and earnings, comparable with the increases shown by the quarterly figures reported earlier by many of the same companies. The increases for the full year are turning out to be almost as good as those shown for the first nine months, with fourth quarter gains even over the excellent final quarter of '54.

Our tabulation of the statements for the year now available from 2,439 corporations shows combined net income after taxes of approximately $14.3 billion, compared with $11.3 billion in 1954, an increase of 26 per cent. These companies, operating in practically every major industry, are representative mainly of the large and medium-size organizations in their respective lines of business.

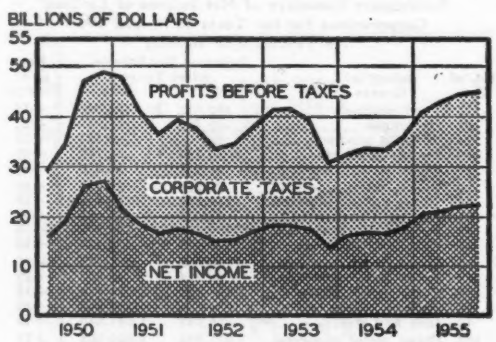
For the reporting manufacturing companies as a group the net income was up 31 per cent. Figures available by quarters for 466 such companies show the December quarter 15 per cent above the September quarter, and 26 per cent ahead of the December quarter of 1954.

Preliminary Summary of Net Income of Leading Corporations for the Years 1954 and 1955
(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income After Taxes 1954	1955	Per Cent Change
115	Food products	$ 358,018	$ 402,365	+12
87	Beverages	129,253	129,057	—
15	Tobacco products	94,101	108,631	+15
58	Textile products	52,134	86,754	+66
27	Clothing and apparel	10,797	14,281	+32
20	Shoes, leather, etc.	26,560	32,320	+22
20	Tires, rubber products	164,451	211,100	+28
30	Lumber, wood prod.	83,054	124,440	+50
49	Paper and allied prod.	190,460	235,105	+23
51	Chemical products	736,602	922,478	+25
26	Drugs, soap, cosmetics	166,530	207,648	+25
15	Paint and varnish	34,674	44,857	+29
52	Petrol. prod. & ref.	1,433,131	1,625,870	+13
66	Cement, glass, stone	305,268	411,660	+35
42	Iron and steel	626,742	1,077,839	+72
402	Other metal products	1,327,700	1,559,003	+17
52	Automobiles & parts	1,168,021	1,915,372	+64
41	Other transp. equip.	162,746	181,177	+11
53	Misc. manufacturing	50,901	49,822	— 2
1,171	Total manufacturing	7,121,138	9,339,774	+31
17	Metal mining	44,709	71,640	+60
18	Other mining, quarry.	50,241	66,903	+33
35	Total mining, quarry.	94,950	138,543	+46
15	Chain stores — food	65,565	70,115	+ 7
37	Chains — variety, etc.	90,206	118,683	+32
27	Department & spec.	67,884	86,533	+27
35	Wholesale and misc.	42,206	52,351	+24
114	Total trade	265,861	327,682	+23
130	Class 1 railroads	677,000	917,000	+35
44	Other transportation	70,809	86,029	+21
174	Total transportation	747,809	1,003,029	+34
161	Elec. power, gas, etc.	1,014,244	1,142,490	+13
49	Telephone & telegraph	621,911	752,850	+21
210	Total public utility	1,636,155	1,895,340	+16
19	Amusements	37,642	41,918	+11
19	Restaurant and hotel	3,786	4,776	+26
25	Other business services	79,722	91,480	+15
10	Construction	12,102	16,599	+37
73	Total amuse., ser., etc.	133,252	154,773	+16
350	Commercial banks	766,517	784,740	+ 2
17	Fire & casualty insur.	41,947	40,268	— 4
181	Investment trusts	339,876	404,758	+19
61	Sales finance	171,673	182,461	+ 6
53	Real estate	13,013	11,871	— 9
662	Total finance	1,333,026	1,424,088	+ 7
2,439	Grand total	$11,332,191	$14,283,229	+26

Annual totals of net income for the reporting companies engaged in trade were up 23 per cent, while transportation was up 34 per cent, public utilities up 16 per cent, and finance up 7 per cent. A preliminary summary of the changes is given in the foregoing table.

The number of companies reporting increases in net income last year exceeded those having decreases by a ratio of 3-to-1. The widespread gains reflect the vigorous recovery from the recession of 1954 in production of goods and services; also resumption of the long-term growth trend of American business generally. Another important factor was the continued heavy investment which served both to expand capacity and to lower operating costs. The combination of these and other favorable conditions enabled corporate business generally to offset the persistent rising trend of labor, material, tax, and miscellaneous costs, and realize the highest net income of any year in history except 1950. At that time earnings were swollen by booming demand and price inflation brought about by the outbreak of war in Korea.



Quarterly Earnings Before and After Taxes of All U.S. Corporations, as Computed by Department of Commerce (Seasonally adjusted annual rates.)

Although the high level of corporate net income, in the aggregate, realized in 1955 apparently was slightly below that all-time peak reached five years earlier – by a margin of less than 3 per cent according to preliminary government estimates – many other related sectors of the national economy last year had risen far above their 1950 levels. For example, during that five-year period the country's average nonfarm employment increased 8 per cent, wages and salaries increased 42 per cent, and the gross national product, representing the dollar value of all goods and services produced, increased 36 per cent. In the distribution of that national product during the same period, personal consumption expenditures were up 30 per cent, government purchases of goods and services were up 81 per cent, and corporate outlays on plant and equipment – despite the lower corporate net income – were up 45 per cent.

During the five years 1951-55 inclusive, total corporate business (excluding banking and insurance) invested approximately $153 billion for expansion and modernization of properties, plus building up inventories, receivables, etc. These huge additions of new capital helped business to finance more sales and to earn more profits. Owing however to competitive conditions and to rising costs and taxes, the increase in profits was not commensurate with the broadening of the invested capital base, and hence the rates of return thereon were lower.

Analysis of the statements of the larger manufacturing companies reporting thus far indicates that total dollar sales billed were up about 13 per cent from the preceding year. Pre-tax earnings were up 26 per cent; the reserves for federal income tax liability were up 22 per cent; and net income after taxes was up, as already noted, by 31 per cent. The proportion of earnings taken by such taxes rose from an average of 48 per cent in 1954 to 50 per cent in '55.

A group of 42 steel companies expanded their tonnage output to a new all-time record and realized an increase in net income of 72 per cent, though their 1955 rate of return on net assets was no more than the average for "total manufacturing". Other industries realizing sharp percentage gains in net income, partly as a rebound from a slump in '54, include textile products, clothing and apparel, lumber and wood products, chemicals, paints, tires, automobiles and parts. A good showing for the cement-glass-stone group resulted from the boom in building and construction generally.

Among the reporting public utility systems supplying electric, gas, telephone, and other services there was, with rare exceptions, a continued growth in gross revenues and in net income. Class 1 railroads had a rise of 8 per cent in total operating revenues, owing principally to the recovery in freight traffic since the trend of passenger and mail revenues was still downward. Railroad operating expenses also advanced, but the balance of net income after taxes rose 35 per cent from its depressed base of the preceding year.

Many additional corporate annual reports are still to be issued during the month of March and will be included in a detailed summary in our April issue, which will also show by major industry groups the average rates of return on net assets and profit margins on sales.

Corporate Uses and Sources of Funds

American corporate business absorbed an estimated $39.5 billion of funds last year to establish a new all-time record, according to the President's Economic Report submitted to Congress. This compares with about $21 billion used in 1954 and with previous peaks of $36 billion in both 1950 and '51. Outlays on plant and equipment amounted to $24.5 billion, also a new high and up $2 billion from the preceding year. Most of the increase in the total, however, resulted from building up current assets – cash, government securities, receivables, and inventories – which absorbed $15 billion in contrast with a net liquidation of $1 billion in 1954, as shown in the table.

Estimated Uses and Sources of Funds of All U. S. Corporations, Excluding Banks and Insurance Companies

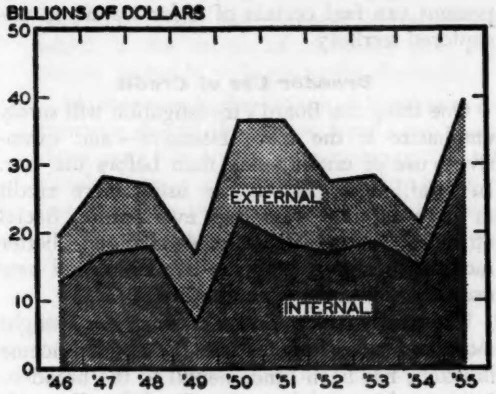
(In Billions of Dollars)

Uses of Funds	1953	1954	1955	10 Years 1946-55
Cash & U. S. Govt. securities	$ 1.2	$—1.0	$ 3.5	$ 11.6
Receivables, net	0.7	1.9	6.5	27.1
Inventories	2.6	—2.8	4.0	42.8
Other current assets	—0.1	0.6	1.0	2.8
Total current assets	4.4	—1.3	15.0	84.3
Plant & equipment outlays	23.9	22.4	24.5	196.3
Total uses	28.2	21.2	39.5	280.7
Sources of Funds				
Bank & mortgage loans	0.5	—0.9	4.5	21.9
Federal income tax liability	1.3	—4.1	3.5	8.7
Other current liabilities	0.8	0.3	1.5	12.4
New security issues, net	7.0	6.1	6.0	54.6
Total external sources	9.6	1.4	15.5	97.6
Retained net income & depletion	6.8	6.2	9.5	89.0
Depreciation & amortization	11.7	13.1	14.5	89.2
Discrepancy — not reported	0.1	0.4	—	4.9
Total sources	28.2	21.2	39.5	280.7

For the 10-year period since the end of World War II the cumulative demand for funds by all corporate business, excluding banks and insurance companies, aggregated $281 billion. Of this total, $196 billion or 70 per cent went into expansion and modernization of properties while $84 billion or 30 per cent was used for building up current assets.

The sources of the funds used last year were to a major extent internal, with $24 billion being obtained from retained net income and allowances for depreciation and depletion. Despite these large funds obtained internally, it was necessary to rely heavily on outside sources for additional capital. Bank and mortgage loans increased by $4.5 billion and new security issues, mostly bonds, provided $6 billion net.

During the years 1946-55, as shown in the chart, only about one-third of the aggregate funds absorbed was obtained from external sources; the other two-thirds came from retained net income and allowances for capital consumption. Annual charges for depreciation and amortization alone (exclusive of depletion) have risen from $4.2 billion in 1946 to $14.5 billion last year or more than three-fold.



Internal and External Sources of Funds Used Annually by All U. S. Corporations, Except Banks and Insurance Companies

Consumer Credit Inquiry

The spectacular expansion of consumer credit in 1955 contributed to the rapid recovery in general business, but also aroused considerable apprehension that people were getting overburdened with debt. On February 20, 1956, the Board of Governors of the Federal Reserve System announced that, at the request of the Council of Economic Advisers, it was undertaking a study of consumer credit. This followed President Eisenhower's suggestion in his Economic Report that a study of the need for standby authority to regulate instalment credit terms would be timely. The inquiry will "analyze the part played by instalment credit in the fluctuations in major consumer industries and the general economy" and appraise the feasibility and effects of controls.

Many persons will disagree over the need for standby credit controls, but welcome an authoritative study in the whole area of consumer credit. The rapid expansion of the past year has carried credit well beyond the old criteria of what was considered safe and sound. Nearly $28 billion of instalment credit was outstanding by the end of 1955, a record total and a record increase of $5½ billion during the year. The total was 10.4 per cent of personal income after taxes, compared with the prewar peak of 7.3 per cent in 1940. Maturities on auto loans stretched out to 3 years or more and down payments shrank to the vanishing point.

These levels, terms, and relationships with income may prove to be sound enough, but few

persons can feel certain of it for we are in unexplored territory.

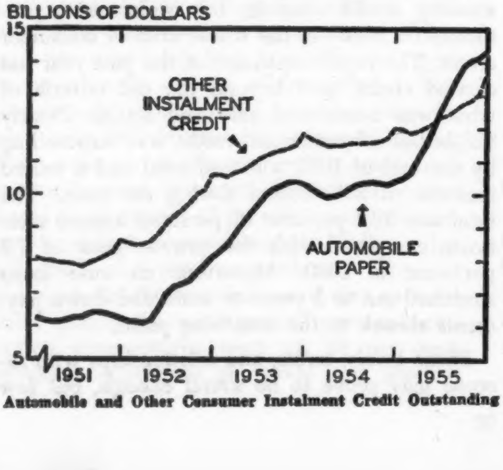
Broader Use of Credit

One thing the Board's investigation will surely emphasize is the more intensive—and extensive—use of credit today than before the war. In brief, more persons are using more credit in more different ways than ever before. Social attitudes toward debt have changed, better facilities for borrowing are available, and new uses are constantly springing up.

The steady rise in incomes, which has brought more and more families into the middle-income brackets, has been fundamental to the broadening use of consumer credit. Traditionally, middle-income families have accounted for the bulk of consumer credit.

According to estimates based on government data and published in *Nation's Business* for November 1955, the number of consumer units with after-tax income of $4,000 or more in constant 1955 dollars has increased 85 per cent since 1941, against a rise of only 25 per cent in the over-all number of consumer units. In other words, the group with purchasing power equivalent to $4,000 or more at today's prices has increased 3½ times as fast as the general average. More than half of all consumer units are now in the $4,000 to $10,000 bracket.

Many of these families have moved into income brackets where for the first time they are able to buy a new car, to afford a home of their own, to upgrade their durable goods purchases, and to command the credit needed to satisfy these desires. Higher incomes, over and above the subsistence level, traditionally bring increased demands for durable goods, and at the same time bring the means to obtain them by increasing both current purchasing power and credit eligibility.



Automobile and Other Consumer Instalment Credit Outstanding

These trends have been at work throughout the postwar decade. The 1955 increase in credit was unusually sharp, however, because of the booming automobile market, as shown in the accompanying chart.

Many reasons have been advanced for the unprecedented sales of new cars in 1955, including styling, discounting, upgrading of demand, and the growth of two-car families. A major part in this outstanding sales performance should, however, be attributed to plentiful credit and easier terms. Some dealers and lenders liberalized terms in 1955 well beyond previously accepted standards. They broadened the market and increased sales, but they also brought into question the soundness of credit based on such terms. The problem of preserving the quality of credit was stressed by Allan Sproul, president of the Federal Reserve Bank of New York, who stated last December:

> I am disturbed not by the total amount of consumer credit, but by the fact or the indication that successive relaxation of terms has been largely responsible for keeping the ball in the air. This is a process which cannot go on indefinitely . . . .

So far, losses and delinquencies have remained low, but that may not be much of a test with times so prosperous and incomes so high.

Instalment Credit and the Business Cycle

What happens to all this credit if business takes a turn for the worse? And what happens to business generally when consumer credit expands or contracts? These questions will certainly be a basic part of the Federal Reserve study.

Theoretically, instalment credit *accentuates* booms and recessions but does not *cause* upturns or downturns. In revival, instalment credit contributes to purchasing power and helps put men and machines back to work. In the later stages of a boom with many lines bumping against the ceiling of capacity, it—like any form of credit—adds fuel to the fires of inflation. In a downturn, repayments subtract from badly needed purchasing power.

In recent recessions the supposedly deflationary force of consumer debt has not been much in evidence. In 1946 and again in 1949, apart from purely seasonal fluctuations there was no net reduction in instalment debt at all, and outstandings rose steadily throughout the year. In 1954, instalment repayments exceeded new credit granted in the early part of the year, but the amount outstanding declined only 1½ per cent or $315 million, seasonally adjusted. By late spring, the volume of credit was rising again and

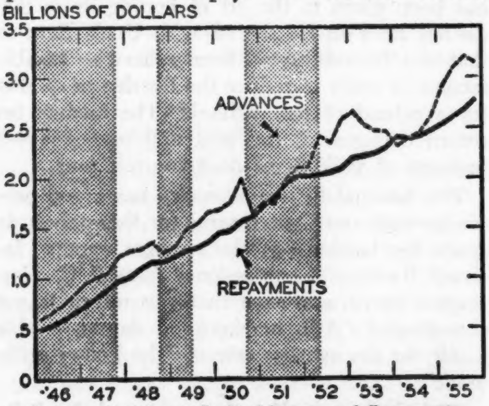
contributing to purchasing power several months before industrial production turned the corner.

It might be argued that instalment credit contributes a cushioning effect in recessions of the 1949 and 1954 magnitude, so long as confidence is maintained. The roughly 95 per cent of workers who remain employed are enabled to keep on buying so long as both borrower and lender have confidence in the worker's employment prospects over the term of the loan. The fact that, on the average, close to $2½ billion of new instalment credit was advanced each month during 1954 makes it clear that the sustaining force of instalment credit does not vanish like the dew at the dawn of economic adversity.

To make this possible, confidence in the limited scope and duration of the downturn is essential. Without such confidence, instalment credit would revert to its supposed role of intensifying the downturn; both the reluctance to incur or advance new instalment debt and the continuing necessity for repayment of old debt would reduce retail sales.

What Next?

Throughout 1955, instalment credit was extended at a much faster rate than it was repaid, as shown in the chart below. In the fourth quarter of 1955, however, new advances slowed up and the rate of repayments continued to rise.



Consumer Instalment Credit Advances and Repayments
(Seasonally adjusted, quarterly averages of monthly data. Shaded areas represent periods of consumer credit controls.)

In 1956, the number of new cars sold is expected to be appreciably less than in 1955, and sales of other consumer goods have been leveling off for some time now. It seems likely that the volume of consumer durable goods sales and hence of instalment sales credit extended will be somewhat lower this year than in 1955. A partial offset may come from increased emphasis on home improvement loans. On the other hand, repayments are expected to maintain their steady rise. Thus, the net increase in outstandings, which is the excess of advances over repayments, probably will gradually diminish.

In other words, the growth of instalment credit this year should slow down from a run to something more like a walk. The economy as a whole should have a chance to grow up to its debt burden. The problem of too rapid expansion of debt may be solving itself without any necessity for direct regulation.

Over the longer run, it needs to be recognized that expansion of consumer credit is in itself not necessarily a cause for alarm. Instalment credit is a growing part of a growing economy and performs many useful functions. It still is not clear, however, how much further the proportion of business done on credit can rise without danger. Obviously it cannot expand indefinitely. But an economy characterized by high employment, steady work, and rising incomes can support a much larger volume of credit without strain than one which is erratic or depressed.

Selective vs. General Credit Controls

The foregoing is suggestive of the kinds of questions that will present themselves to the Reserve authorities under that portion of their terms of reference calling for analysis of "the part played by instalment credit in the fluctuations in major consumer industries and the general economy." There remains the question of direct, or "selective", control of instalment credit terms by the Reserve Board or other governmental authority, versus reliance upon general credit controls exercised through such instrumentalities as Federal Reserve open market operations and discount rates, and changes in bank reserve requirements.

Here two kinds of questions arise – those of fact and of principle.

As regards the first, the key point is whether, as often claimed, consumers and lenders to consumers are not sufficiently sensitive to general credit pressures and changes in interest rates; or whether, as considerable evidence seems to indicate, lenders do in fact react to general credit pressures and rising interest rates in ways that affect credit volume, particularly through the application of stricter credit terms and standards.

As regards the second, the question is the relative merits of attempting to regulate particular kinds of lending – with all the administrative difficulties, inequities, and arbitrary interferences by government with the freedom of

individual decisions both on the part of lenders and consumers — as against over-all credit controls that leave the rationing of available credit to the free action in the market of the various individual lending institutions.

These are man-size questions. Whatever the Reserve Board experts may come up with in the way of answers will be awaited with keen interest by lenders, manufacturers and dealers whose sales depend on instalment credit, and all those who follow credit developments generally.

Do-It-Yourself

The "do-it-yourself" movement is one of the most striking developments of the postwar years. People undertake all manner of repair jobs; decorate and remodel their homes; build furniture, garages, boats and toys. They equip workshops and studios; acquire working knowledges of painting, paperhanging, carpentry, plumbing and electricity. Across the countryside one can even see people building their own houses from the foundation. The five-day week, more paid holidays and vacations, and compensated unemployment give extra time for home projects.

Do-it-yourself has become a big business. The Do-It-Yourself Information Bureau in New York estimates that people are spending $7 billion a year for materials and equipment. It is said that amateurs buy 75 per cent of all interior paint sold in this country, 60 per cent of all wallpaper, 50 per cent of all floor tile, and 42 per cent of all plywood. How-to-do-it books number in the thousands. Adult courses teaching arts and crafts are more popular than ever. Manufacturers design products for easy home use. In a number of cities do-it-yourself shows have attracted attendances running up to 100,000 persons.

Comparatively few people attain professional skill. The jobs undertaken rarely are as easy as they look. Nevertheless, there are satisfactions in tangible achievement and the mastery of a knack. Away from the discipline of massed employment, it is a nice change to be one's own boss on a project, to set one's own pace and quality standards. Do-it-yourself is an expression of the ingenuity, enterprise and self-reliance of the individual. In the age of automation it is good that fundamental arts and crafts are not being lost.

Aside from these aspects, which give variety to life and outlets for creative energy, the do-it-yourself movement reflects efforts of people to make up for shortage in the supply of hired labor. The postwar decade has been a period of over-full employment, booming construction, and rising wages. Building, plumbing, electrical and painting contractors not unnaturally favor the bigger projects. Industry has tempted the odd-jobs handyman into regular employment. While anything mass-produced is comparatively cheap, custom-made products are impossibly dear. A person often is forced to handle his own maintenance and repair job because no one else can be found to do it, at least within any sensible cost. When a skilled surgeon, dentist, or diemaker is compelled to take time off to fix a leaking pipe or glaze a broken window there is waste of human resources. Over-full employment undermines the efficiency of the economy.

This uneconomic application of labor is accelerated by the income tax. The marginal dollar the surgeon, dentist or diemaker earns in his regular work has to be shared with Uncle Sam. It shrinks to seventy, sixty, fifty cents or even less. The greater the skill, the higher the tax. There is no tax on what you do for yourself.

The Art of Taxmanship

Do-it-yourself projects give benefits free of income tax. And there is no tax on the time devoted to filling out the income tax return and studying ways and means of easing the tax burden. "Taxmanship" is the generic name that has been given to the art of finding items that do not have to be shared with Uncle Sam or that can be subtracted from otherwise taxable income in order to reduce the tax due or qualify for a refund of tax withheld. The income tax return engages all the wits and money-saving instincts of millions of do-it-yourself fans.

The Internal Revenue Service has urged people to work out their returns for themselves, to spare the burdens on the revenue agents. Internal Revenue Commissioner Russell C. Harrington gives assurance that the return is not complicated: "A high school kid should be able to fill out the average return if he knows arithmetic".

With do-it-yourself projects outward simplicity is often deceptive. The real do-it-yourself fan ignores the simplicities of the law so as to give undivided attention to the complexities. The biggest-selling of all how-to-do-it books are the popularized guides to income tax savings.

According to Sidney Margolius, writing in *Harper's* a year ago on "The Art of Taxmanship or How to Save Money Without Going to Jail":

> In these days of soaring taxes, the strategy of tax avoidance — or taxmanship — has become a new national pastime, second only to baseball in general interest and

to none in excitement, because more people can play and all of them play for keeps.

To provide for the growing enthusiasm for the game, a sizable new industry — tax experting, the science of "minimizing" — has sprung up with a literature and code all its own. J. K. Lasser's tax guide alone has sold more than thirteen million copies in its eighteen years as the taxpayer's *vade mecum*, and this year its sales are running 100 per cent ahead of last.

There are also seven other annual guides, and Commerce Clearing House — one of the big professional tax services which ran its presses on three shifts during 1954 — is currently building a huge new plant to keep up with the national hunger for tax tips. There is even a Tax Book Club for deduction aficionados and a monthly magazine, *Taxes*.

The taxmanship movement has a simple foundation. Congress has been remiss in getting tax rates down to tolerable levels. So the enterprising citizen is driven to do it himself.

Gratifying as it is to observe still another manifestation of the resourcefulness of the American people, there are some less satisfactory aspects of the movement. The income tax rates set the rewards for evasion so high that the basic honesty of the people is sorely tested. Mr. T. Coleman Andrews, Mr. Harrington's predecessor as Internal Revenue Commissioner, said on a radio program a month ago that the present progression of personal income tax rates is "the greatest potential that anyone has ever thought of for making out of us a nation of liars and cheats".

It would be well for the Congress to give heed to trends that undermine the moral base of our civilization.

"People's Capitalism"

Workers will be busy in Washington's Union Station for the next few weeks packing and crating this country's latest entry in the world-wide "war of ideas." It's a U.S. Information Agency-sponsored exhibit to illustrate "People's Capitalism." This is the newest name to describe our economic system — one under which a large percentage of the people own the means of production and under which workers share in the results of increased output through higher wages and more abundant goods at lower prices.

The exhibit's main features are a typical worker's house, 1776 vintage, and one of today's models — complete with automatic dishwasher, garbage disposal unit and a car parked in the garage. Panels and displays chronicle the tremendous improvment in living standards that has taken place in the U.S. over the years. Some 25,000 people trooped through the exhibit in a week-long Washington preview last month; it's now being readied for shipment to India, Japan and other Asian countries before reaching the European trade fairs this summer.

The Advertising Council, which advanced the idea to the U.S.I.A., thinks the exhibit will demonstrate to the world the benefits for individuals under the American economic system. Dramatic illustration of some of these benefits came out in fairly routine announcements not long ago. The American Iron and Steel Institute reported steelworkers have become men of "substantial means", averaging a weekly paycheck of $103. Ivan L. Wiles, vice president of General Motors and manager of the Buick division, announced average earnings of the 90,000 people employed by GM in its five divisions in Flint, Mich., were $5,460 last year, compared with $4,200 for fewer persons in 1950. Significantly, he added:

> The employe in our shop can — and does — buy a Buick. For the first time, it's gotten so the man on the assembly line can buy what he makes.

These evidences of growing and widely diffused prosperity in this country contrast sharply with workers' rewards under different economic systems. The idea of the exhibit, of course, is to show all people how our way of doing things provides more of the necessities and good things of life to more people than any society man has yet produced — all under a system that cherishes individual freedom. The story needs telling; ignorance and misunderstanding crop up here — and abroad — not only among uninformed workers, but in high political circles as well.

This spectacle of abundance for the common man calls to mind a recent statement by Hugh Gaitskell, Chancellor of the Exchequer in the former Labor Government of Great Britain and now Clement Attlee's successor as British socialist leader. His Labor party appeals to voters with a "fair shares for all" slogan. A few months back Mr. Gaitskell explained his reasons for backing socialist economics this way:

> . . . I am a Socialist because I hate and loathe social injustice, because I hate the class structure that disfigures our society, because I hate poverty and squalor. I want to see a society in which rewards go according to merit . . . I want to see all this achieved by democratic means . . .

As the U.S. Chamber of Commerce has aptly suggested: "Mr. Gaitskell, you might try capitalism."

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